



#39381

**TO: ALL CLEARING MEMBERS AND EXCHANGES**

**DATE: JULY 22, 2016**

**SUBJECT: OPTIONS ALLOCATION SYSTEM**

### **Allocations Introduction**

The options industry currently uses CMTA Agreements to allow Clearing Members to move trades/positions from an executing firm to a take-up firm. The methodology used for CMTA trades and CMTA transfers places risk on take-up Clearing Members. In order to accept *any* transaction, the take-up must accept all transactions from a given counterparty. To add controls to this process, OCC will be moving away from CMTAs to Allocations.

Allocations create a more flexible process that will allow take-up firms the ability to accept or reject selected trades/post trades as opposed to forcibly accepting all trades/post trades. Clearing Members will be required to have profiles in place, set to auto-accept or non-auto accept. If an auto-accept profile is in place, trades are automatically cleared in the take-up firm's account. If a non-auto profile is in place, the take-up firm has an opportunity to accept or reject the trades/ allocations. Moving from CMTA transfers to allocations will allow the take-up firms a chance to evaluate transactions before accepting them.

This project will be installed in two phases with Phase One scheduled for October 2017 and Phase Two scheduled for February 2018. Each phase is discussed in detail below. OCC will require extensive testing prior to launch and will produce detailed testing scenarios later this year.

### **Definitions**

- **Executor/Executing Firm:** The firm that executes a trade on the exchange or the firm that enters an allocation post trade.
- **Take-Up Firm:** The firm that is intended to clear a trade or given an allocation post trade. This was previously referred to as give-up firm.
- **Allocation:** Transaction used to move a position from an executor to take-up firm either through a post trade or system generated allocation.
- **Post Trade Allocation:** Post trade submitted by an executing firm to move a trade/position to a take-up firm. This transaction will replace CMTA transfers.
- **System Generated Allocation:** Allocation created by OCC if a take-up firm is identified on a trade and a non-auto profile exists.
- **Allocation Acknowledgement:** The response sent by a take-up firm indicating their decision to accept or reject an allocation.

## **Option Allocation Profiles**

The Option Allocation Profile will govern processing for both trades and post trades. CMTA Agreements will no longer be used. The profile can be setup as auto-accept or non-auto for both trades and post trades. It is possible that trades can be set to auto and post trades set to non-auto and vice versa.

- Auto - If auto is selected, trades will automatically clear in the take-up account and post trade allocations will automatically move to the take-up. Processing is the same as with CMTA Agreements.
- Non-Auto - If non-auto is selected, take-up firms will have the ability to accept or reject the trade/post trade before it enters their account.
- No Profile - If a profile does not exist between an executor and take-up and a trade is executed, the trade will default to the executor's account. Post trades will reject.

The Allocation profile will be accessed via ENCORE. Unlike CMTA Agreements, firms will not select individual exchanges when setting up a profile. Profiles between two firms will cover all options exchanges. Additionally, OCC will continue to allow SCARF when setting up an allocation profile. Firms will select "allow fees" when setting up the profile if they wish to have the ability to move clearing and regulatory fees on post trade allocations.

As it is with CMTA Agreements today, profiles must be approved by the contra to become active, modified or deleted. A new feature of the allocation profiles is an email notification. Firms will be notified via email when a new profile has been proposed to be added, modified or deleted and once an agreement has been approved for addition, modification or deletion. An additional enhancement with allocations is that firms will not be required to set up profiles between the same OCC clearing number or clearing numbers within the same legal entity.

## **Phase One – Auto Profiles**

In phase one, CMTA Agreements will be decommissioned and firms will begin using Allocation Profiles. OCC will add Allocation profiles based upon existing CMTA Agreements. OCC will work with firms to clean up the existing agreements prior to conversion. In this phase, all profiles will be set to auto-accept. Firms WILL NOT have the ability to set profiles to non-auto.

### Trade Processing

As profiles will be set to auto, all trades will automatically clear in the take-up account just as CMTA trades do today. Should a profile not exist, trades will default to the executor's default account. Trade processing will be a seamless transition with the use of auto allocation profiles. Additionally, OCC will continue to process busted and backed out trades as it does today.

### Post Trade Processing

The key change for phase one will be the decommissioning of CMTA transfers and the introduction of options allocations. On the go-live date, OCC will no longer accept CMTA transfers and all firms must utilize Allocations for post trades. Allocations can be entered manually via ENCORE or sent to OCC via FIXML messaging. Allocations can be viewed via ENCORE screens and DDS messaging will be provided. All Clearing Members, service bureaus, exchanges and regulatory bodies that receive FIXML messaging from OCC must be able to read FIXML allocation messages day one. In addition, any firm that sends CMTA transfers via FIXML messaging must be able to send inbound allocation messages. OCC will no longer support FIXML messaging for inbound or outbound CMTA transfers.

### Reversals

As all profiles will be set to auto-accept in phase one, all allocation trades and post trades will automatically move to the take-up account and have a status of claimed. Should a take-up firm receive an allocation in error, they cannot delete the claimed allocation. However, they can submit a reversal which

requires contra party approval. A reversal in essence cancels the allocation and the position is moved back to the executor. A reversal can be manually entered in ENCORE or transmitted via FIXML, and must be approved by the contra party by the window close. If a reversal is not approved by the contra party prior to window close, the position will remain in the take-up account. All Clearing Members, service bureaus, exchanges and regulatory bodies that receive FIXML messaging from OCC must be able to read FIXML reversal messages on day one.

#### Fees

OCC clearing fees, section 31 fees and cleared volume will be assessed to the take-up firm on trades as they are today with CMTA Trades. Fees will not move on post trade allocations.

#### ORF

Firms should contact the exchanges to understand ORF calculations as it relates to the new process.

#### Post Trade Allocation Window

The allocation window will close at 5:00 PM CT on a daily basis for options allocation post trades and reversals. Any allocations, reversals or acceptance of reversals submitted after this time will be rejected. Should a firm need an extension they must contact OCC before the window close. If exchanges are late sending OCC trades for the day, OCC will extend the window until trades are received.

## **Phase Two – Non-Auto Profiles**

In phase two, firms will have the ability to set profiles to non-auto. If set to non-auto, take-up firms will have the ability to review trades/allocation before accepting them into their account. Take-up firms must have a real-time system and be certified by OCC's External Testing team to set up non-auto profiles. Execution firms must have the ability to monitor unclaimed allocations and trades.

#### Trades Processing

If trade profiles are set to non-auto, trades will clear in the executor's default account and system generated allocations will be created. The system generated allocation will be in an unclaimed status and the position will remain in the executor's account. Unclaimed allocations can be viewed in ENCORE and real-time FIXML messaging will be sent to both the executing and take-up firms should they subscribe. The take-up firm can accept or reject the allocation in ENCORE or via inbound allocation acknowledgement FIXML messaging. Should the allocation be accepted, the allocation status in ENCORE will change to claimed and the position will move from the executor to take-up firm. Both the executing and take-up firm will be notified of the acceptance via FIXML messaging. Should the allocation be rejected by the take-up, the status will change to rejected in ENCORE and both the executing and take-up firm will be notified of the rejection via FIXML messaging.

Each system generated allocation will contain an allocation ID and will follow the allocation through the accept/reject acknowledgement process. This unique ID will also be included on the cleared trade message. This ID will allow the firm and exchanges to associate the allocation back to the original trade.

Firms will have until T+1 to accept or reject an allocation. Should the allocation not be accepted on T, the position will remain in the executor's account overnight and they will be responsible for satisfying the settlement, margin requirement, and any exercise/assignment activity. Execution firms should monitor pending allocations to ensure take-up firms are accepting on a timely basis. OCC will cancel any allocations that are not claimed by end of day T+1. Additionally, OCC will cancel any allocations not claimed on T that go through a corporate action or expire. DDS messaging will be provided for allocations that are cancelled.

If a trade is busted or backed out, the original trade is cancelled. For auto-trades, the trade would be busted just as it is today. For non-auto trades, both the trade and system generated allocation will be cancelled. This includes system generated allocations that are in a claimed or unclaimed status. Post trade allocations entered by Clearing Members WILL NOT be cancelled, just as CMTA transfers are not affected by busted or backed out trades today.

### Customer ID

It is important to note that the use of valid Customer ID information is imperative to the allocation process. Firms will use the Customer ID in deciding which allocations to accept or reject. Clearing members are encouraged to begin working with their counterparties immediately to understand the Customer ID needs of each firm.

In order to ensure execution firms are supplying Customer ID information on trades, OCC will default trades that do not contain a customer ID to the executor's account. OCC WILL NOT create a system generated allocation to the take-up firm. Execution firms would need to allocate the defaulted trade to the take-up firm (allocations require Customer ID) or have the trade busted and resubmitted with the Customer ID information. This logic will be turned on after phase one but prior to phase two.

### Reversals

Reversals are not allowed on system generated allocations. Reversals are only allowed on Clearing Member initiated post trade allocations. If a take-up firm accepts a system generated allocation in error, they should work with the executor to correct the trade or allocate the position back to the executor via post trade.

### Fees

OCC clearing and section 31 fees will be assessed to the execution firm when the trade first clears in their account. Should the system generated allocation be accepted by the take-up firm on trade date, the fees will move to the take-up firm. Fees WILL NOT move to the take-up firm should the allocation be accepted on T+1. Firms must settle these fees amongst themselves as they would today if a trade remained in their account overnight. As with fees, cleared volume will be assessed to the execution firm once the trade clears and will be moved to the take-up firm if the system generated allocation is claimed on T. Cleared volume will not move to the take-up firm should the system generated allocation be claimed T+1.

### ORF

Firms should contact the exchanges to understand ORF calculations as it relates to the allocation process.

### **Post Trade Processing**

As with trades, firms will have the ability to set profiles for post trades to non-auto in phase two. If post trades are set to non-auto, allocations will be in an unclaimed status until accepted or rejected by the take-up firm. When the executor initiates a post trade allocation, the transaction can be viewed in ENCORE with the allocation showing a status of unclaimed. Both the executor and take-up firm will be notified via real-time DDS that an allocation has been proposed. The take-up firm can then accept or reject the post trade allocation via an allocation acknowledgement. This can be manually completed in ENCORE or via allocation acknowledgement FIXML messaging to OCC. If accepted, the status of the allocation will change to claimed, the position will move to the take up and both the executor and take-up firm will be notified via FIXML messaging. If the take-up firm rejects the allocation, the status will change to rejected, the position will remain with the executor and both parties will be notified of the rejection via FIXML messaging.

As with system generated allocations, post trade allocations can be accepted until T+1. Should the allocation not be accepted on T, the position will remain in the executor's account overnight and they will be responsible for satisfying the margin requirement and any exercise/assignment activity. Execution firms should monitor pending allocations to ensure take-up firms are accepting on a timely basis. OCC will cancel any allocation that is not claimed by window close on T+1. Additionally, OCC will cancel any allocation not claimed on T that goes through a corporate action or expire. DDS messaging will be provided for allocations that are cancelled.

## Reversals

If a firm claims an allocation in error, Clearing Members cannot delete the claimed allocation. However, they can submit a reversal. Reversals can be submitted by either the executor or take-up firm and must be claimed by the contra firm even if an auto-accept profile is in place. Reversals can be manually requested via ENCORE or by submitting a FIXML message. OCC will then generate FIXML messaging to both firms with the notification of the pending reversal. The contra firm can then decide to accept or reject the reversal request either manually in ENCORE or via FIXML messaging. Once the contra response has been made, OCC will generate DDS messaging to both parties stating the acceptance or rejection of the reversal. If accepted, the position will move back to the executor. If rejected, the position will remain in the take-up account.

All reversals must be accepted or rejected on the date the allocation was accepted. Any reversal request that has not been responded to by the window close will be cancelled. OCC will not provide DDS messaging for dropped reversals. Additionally, OCC will not allow a reversal for an allocation that was claimed the previous day. If a firm notices an allocation was claimed in error the previous day, the firm should enter the opposite allocation.

## Fees

Clearing fees and section 31 fees DO NOT move on post trade CMTA transfers and will not move with options allocations. These fees should continue to be settled between firms as they currently are with CMTA transfers.

## Post Trade Allocation Window

As with phase one, the window for allocations, allocation acknowledgements, reversals and reversal acknowledgements is open until 5:00 PM CT. If an extension is needed, firms must contact OCC before the window close. Additionally, OCC will keep the window open past 5:00 PM if all exchanges have not signed off for the day.

## **Impact to Futures Firms**

Although this project primarily impacts options firms, OCC will enhance the futures allocation process with this project as well. The following futures items will be enhanced as a part of this project, launching in October 2017.

- Currently, when allocating multiple futures trades OCC only allows opens to be allocated with opens and closes with closes. At the request of many futures firms, OCC will allow opens and closes to be allocated in the same allocation. In these instances, all allocations will move as opening transactions. Firms will need to submit end of day PCS files to net down positions.
- The new reversal functionality that will be introduced for options allocations and discussed above will be extended to the futures allocation process. Futures firms will now be able to reverse an allocation that was claimed in error.
- Futures firms will now be able to allocate to multiple firms via one screen or one FIXML message.

OCC will be producing an updated futures allocation guide at a future date. As with options allocations, we will offer external testing before the changes are launched. Details on the testing effort will be produced later in 2016.

## **Next Steps**

OCC will publish an Options Allocations Guide as well as an FAQ list the week of July 25, 2016. This documentation will be published to [www.myocc.com](http://www.myocc.com) > Operations > Options Allocations. Firms should begin reviewing this information and plan accordingly. OCC will offer extensive testing beginning in March 2017 and will require all firms to complete specified test scripts. Test scripts and testing timelines will be posted later this year.

OCC will host regularly scheduled allocations meetings through Phase Two of the project. These meetings will be used to relay pertinent information to industry participants, answer questions, and address any

concerns/issues. These meetings will be open to OCC Clearing Members, exchanges and service bureaus that support OCC members. The kickoff meeting will be held in the near future. A meeting invite will be generated to all firms with further details.

Additionally, OCC has created a broadcast email group that will be used to transmit updates, send meeting invites and relay pertinent information on the project. OCC will automatically add the options managers from each firm to this broadcast group. If additional resources should be included from your firm, please email [memberservices@theooc.com](mailto:memberservices@theooc.com) to be added to the distribution.

If you have any questions, please contact your Clearing Member representative or the Member Services Help Desk at the following numbers: 800-621-6072 or 800-544-6091. Within Canada, please call 800-424-7320. Clearing Members may also e-mail us at [memberservices@theooc.com](mailto:memberservices@theooc.com).